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STATE FOR EB/IFD/OIA

PASS TO USTR AND OPIC

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SUBJECT: GUATEMALA: 2005 INVESTMENT CLIMATE STATEMENT

REF: STATE 250356

Following is the 2005 Investment Climate Statement for Guatemala. Report is keyed to format outlined in REFTEL.

Begin text:

VII. Investment Climate

A.1. Openness to Foreign Investment

Many U.S. and other foreign firms have active investments in Guatemala. Though Guatemala passed a foreign investment law in 1998 to streamline and facilitate foreign investment, time-consuming administrative procedures, arbitrary bureaucratic impediments and judicial decisions, a high crime rate and corruption are often cited as reasons why direct investment has been stagnant. A new pro-business administration took office in January 2004, ending the atmosphere of confrontation that existed between the government and the private sector that weighed on investment decisions during the previous four years. There are no impediments to the formation of joint ventures or to the purchase of local companies by foreign investors. The absence of an equities market in which shares of publicly traded firms are exchanged makes non-friendly acquisitions or takeovers virtually impossible. Most foreign firms operate as locally incorporated subsidiaries.

Both domestic and foreign firms must publish their intent to conduct business, agree to Guatemalan legal jurisdiction, and register with the Ministry of Economy in order to incorporate formally in Guatemala. Foreign firms are subject to additional, often time-consuming requirements, including demonstrating solvency, depositing operating capital in a local bank, supplying financial statements, contractually agreeing to fulfill all legal obligations before leaving the country, and the appointment of a Guatemalan citizen or foreign resident (with work permit) as legal representative. The requirements are not used specifically to screen or discriminate against foreign companies, but the procedures can serve as a disincentive to investment.

The Foreign Investment Law removed limitations to foreign ownership in domestic airlines and ground transport companies in January 2004. However, some specific restrictions remain in a few sectors, such as auditing, insurance and forestry. For example, foreign insurance companies are not permitted to open branches in the country but might operate as locally established companies. There are no restrictions on foreign investment in the telecommunications and electrical power generation sectors.

The GOG privatized a number of state-owned assets in industries such as power generation and distribution, telephone, and grain storage in the late nineties. Upon taking office in January 2000, the previous administration indicated that it would review all previous privatizations and concessions, and initiated a process to review the 1999 privatization of the telephone company. In October 2001, the GOG reached an agreement with the telephone company. The previous government also stated that it would unilaterally review all power purchase agreements, affecting the sector with the greatest foreign investment. The government subsequently decided not to take any action. More recently, the semi-autonomous Human Rights Ombudsman successfully reversed efforts by the electrical ratemaking authority to reduce subsidies mandated by the previous administration and establish a more rational rate structure,

efforts supported by the current administration and the IMF. These politically motivated interventions into privatized businesses and their regulatory authorities have tended to erode investor confidence, despite the commitment of the current administration to upholding contracts and respecting regulatory autonomy.
Subsurface minerals and petroleum are the property of the state. Contracts for development are typically granted through production-sharing agreements, which, in the past, were often negotiated in a non-transparent manner. New legislation has resulted in a more transparent process, though the suspension in 2002 of a hydrocarbon exploration contract, on environmental grounds, without due process, raised some concerns among investors. The government is planning to introduce new mining legislation in 2005 to encourage foreign investment in the sector while ensuring modern standards of environmental protection. Recent violent protests of a major gold mining project are a reminder that mining has historically been a sensitive issue in Guatemala.

Tariffs are based on the Common Duty System (SAC) of the Central American Common Market (CACM), which uses an eight-digit code based on the Harmonized Code. In most cases, tariffs range between 0-15 percent.

Guatemalan exports currently enjoy preferential access to the U.S. market through the Caribbean Basin Initiative (CBI), the Caribbean Basin Trade Partnership Act (CBTPA) and the Generalized System of Preferences (GSP). The U.S. - Central America Free Trade Agreement (CAFTA), when ratified and implemented, will expand these benefits and provide additional access and guarantees for U.S. investment, services, and intellectual property rights. Current programs, together with favorable agricultural conditions, favor nontraditional exports such as cut flowers, seasonal fruits and vegetables, which have seen rapid export growth over the last decade. Textile and apparel assembly activities have grown as a result of CBI enhancement in October 2000. However, rising labor costs relative to the Far East and Central American neighbors, high electricity costs, an overvalued local currency, and the WTO-mandated lifting of quotas in January 2005 raise questions over the sector's continued viability. Implementation of the CAFTA, which broadens rules of origin and provides a tariff preference in the U.S. market with respect to Asia, will be critical for the sector.

A.2. Conversion and Transfer Policies

The rights to hold private property and to engage in business activities are specifically recognized by the Guatemalan Constitution. Foreign private entities have the right to establish, acquire and dispose freely of virtually any type of business interest, with exceptions for insurance, auditing and forestry as noted above. Guatemala's foreign investment law protects the investor's right to remit profits and repatriate capital. There are no restrictions on converting or transferring funds associated with an investment (or any other licit activity) into a freely usable currency at a market-clearing rate. U.S. dollars are freely available and easy to obtain within the Guatemalan banking system. There are no legal constraints on the quantity of remittances or any other capital flows, and there have been no reports of unusual delays in the remittance of investment returns. In the past, the Central Bank had the legal authority to impose restrictions on remittances. However, the Law of Free Negotiation of Currencies, in force since May 2001, eliminated the Central Bank's legal authority to impose those restrictions.

The Law of Free Negotiation of Currencies allows Guatemalan banks to offer different types of foreign currency-denominated accounts. In practice, the dollar is the only foreign currency used with any significance. Some banks offer "pay through" dollar-denominated accounts in which the depositor makes deposits and withdrawals at a local bank with the actual account maintained on behalf of the depositor in an offshore bank.

Capital can be transferred from Guatemala to any other jurisdiction without restriction. Guatemalans historically have not participated in

major direct investments outside of Central America, the Dominican Republic, and South Florida (principally real estate).

A.3. Expropriation and Compensation

The Constitution prohibits expropriation except in cases of eminent domain, national interest, or social benefit. The foreign investment law requires advance compensation in cases of expropriation.

A.4. Dispute Settlement

Resolution of business disputes through Guatemala's judicial system is time-consuming and often unreliable. Civil cases can take as long as a decade to resolve. Corruption in the judiciary is not uncommon.

The Government of Guatemala has signed the United Nations Convention on the Recognition and Enforcement of Arbitral Awards (New York Convention) as well as the Interamerican Convention on International Commercial Arbitration (Panama Convention). In addition, Guatemala has signed the Convention on the Settlement of Investment Disputes between States and Nationals of other States (ICSID), which was approved by the Guatemalan Congress in 1996 but has not been ratified by the Executive Branch. The foreign investment law permits international arbitration or alternative resolution of disputes, if agreed by the parties.

Guatemalan procedures for enforcing agreements do not differ significantly from those of the United States. Guatemala's Arbitration Law of 1995 is based on the UNCITRAL Model Law for International Commercial Arbitration. Therefore, Guatemalan regulations applicable to these matters are fully in line with the New York Convention. Default awards and arbitral agreements can be fully enforced in Guatemala.

A.5. Performance Requirements/Incentives

Guatemala does not impose performance, purchase or export requirements other than those normally associated with free trade zones and duty drawback programs. There are no conditions on locations in specific geographic areas or on the percentage of local content in production.

Guatemala eliminated remaining trade-related investment restrictions with the 1998 foreign investment law and became compliant with WTO obligations stemming from the Agreement on Trade Related Investment Measures (TRIMS). Guatemala sent its notification of TRIMS compliance to the WTO in 1999.

Investment incentives are specified in law and are available, with few exceptions, to both foreign and Guatemalan investors without discrimination. The major Guatemalan incentive program, the Law for the Promotion and Development of Export Activities and Drawback, is aimed mainly at "maquiladoras" - manufacturing or assembly operations for which over half of production inputs and components are imported and the completed products are exported. Incentives include exemption of duties and value-added taxes on imports of machinery and a one-year suspension of duties and value-added taxes, which can be extended to a second year, on each import of production inputs and packing material. Taxes are then waived when the goods are re-exported. Some investors claimed that significant payments were demanded by officials of the previous administration in order to process tax waivers or value added tax rebates, but this situation has reportedly improved. Investors in this sector are also granted a 10-year income tax exemption, and are also exempt from the Temporary and Extraordinary Tax to Support the Peace Agreements (IETAP), Guatemala's alternative minimum tax on either net assets or gross income, during the 10-year income tax exemption period. The income tax exemption will be eliminated if the CAFTA enters into force.

Property owners who engage in reforestation activities may qualify for government incentives through the National Institute of Forests (INAB).

A.6. Right to Private Ownership And Establishment

The right to hold private property and to engage in business activity is recognized in the Guatemalan Constitution. The foreign investment law specifically notes that foreign investors enjoy the same rights of use, benefit, and ownership of property as afforded Guatemalans. These rights are subject only to the limitations imposed by the Guatemalan Constitution. Foreigners are prohibited from owning land immediately adjacent to rivers, oceans and international borders.

A.7. Protection of Property Rights

Land invasions by squatters have become common in rural areas. It can be difficult to obtain and enforce eviction notices, as land title is often clouded and the police have tended to avoid actions against squatters that could provoke violence. The government has stepped up its efforts to enforce property rights where title is clear, and some incidents have led to violence and deaths.

Mortgages are available for both home and business purchasers, though in practice, few banks offer loans for residential real estate for longer than five-year terms.

The legal system is accessible to foreigners and does not discriminate on the surface. However, in practice, it favors a "home team" accustomed to maneuvering a case through the process, and corruption is common. The need for foreign investors to secure reliable local counsel cannot be stressed enough.

Regarding intellectual property rights (IPR), Guatemala belongs to the World Trade Organization (WTO) and the World Intellectual Property Organization (WIPO). It is also a signatory to the Paris Convention, Bern Convention, Rome Convention, Phonograms Convention, and the Nairobi Treaty. Guatemala has ratified the WIPO Copyright Treaty (WCT) and the WIPO Performances and Phonograms Treaty (WPPT).

The Guatemalan Congress passed legislation in August 2000 to bring the country's intellectual property right laws into compliance with the WTO's TRIPS agreement. This legislation was modified in 2003 to provide test data protection more consistent with international practice, but December 2004 legislation then effectively removed data protection for pharmaceutical products and agricultural chemicals. The government was expecting to reform this legislation in early 2005 to make it consistent with the requirements of the CAFTA. The Attorney General appointed a special prosecutor devoted to IPR violations in May 2001 in an effort to improve the government's enforcement actions, but successful prosecution of violators is rare.

High piracy rates remain an ongoing concern. The piracy rate for software applications, as reported by the Business Software Alliance, increased from 61 percent in 2002 to 77 percent in 2003 (principally due to a worldwide change in measurement methodology).

A.8. Transparency of the Regulatory System

Bureaucratic hurdles are common for both domestic and foreign companies. Regulations often contain few explicit criteria for government administrators, resulting in ambiguous requirements that are applied inconsistently or retroactively by different government agencies. The administration that assumed power in early 2004 has repeatedly expressed its intention to improve matters, and its initial results have been promising. Most public procurement is now handled through an internet-based system that is open to the public, and a system of "e-government" permitting government requirements to be completed online is reportedly approaching the implementation stage.

The creation of the semi-autonomous Superintendence of Tax Administration (SAT) in 1999 was expected to improve customs procedures, but results under the previous administration were at best disappointing, leading international donors to suspend their assistance. The new government has begun implementing a more

systematic and professional approach to its task, focusing more on advance processing of electronic documentation and less on random inspections. Additionally, corrupt customs officials are being systematically weeded out. Guatemala officially implemented in its domestic legislation the WTO Customs Valuation Agreement on August 10, 2004.

Public participation in the promulgation of regulations is rare, and there is no consistent legislative oversight of administrative rule making.

A.9. Efficient Capital Markets and Portfolio Investment

Guatemala's capital markets are weak and inefficient, though some consolidation and restructuring have begun as the result of financial reforms legislated in the past few years. Guatemala's 28 commercial banks, three of which are currently facing liquidation, have only an estimated USD 9.3 billion in assets among them. The five largest banks control about 61 percent of total assets. In addition, there are about 18 private non-bank financial institutions, which perform primarily investment banking and medium and long-term lending, and seven exchange houses. The Superintendence of Banks (SIB) is charged with regulating the financial services industry.

Previous banking regulations and practices provided banks and other financial services providers wide latitude in valuing assets and evaluating the performance and quality of those assets. In April 2002, the Guatemalan Congress passed a package of financial sector regulatory reforms that have increased the scope of regulation and supervision and brought local practices more in line with international standards. The reforms include a new Banking and Financial Groups Law, a Financial Supervision Law and the Central Bank Law. The laws should encourage further consolidation of the banking system into a smaller number of stronger banks.

According to the new Banking and Financial Groups Law, groups of affiliated credit card, insurance, finance, commercial banking, leasing, and related companies must issue consolidated financial statements prepared in accordance with uniform, generally accepted accounting standards. These groups are then each subject to audit and supervision on a consolidated basis. This is requiring bank groups to include non-performing assets they used to park offshore in their calculation of loan loss provisions and capital adequacy ratios. The new calculations, in turn, are requiring a number of banks to seek new capital, buyers, or mergers with stronger banks. As of December 2004, the Superintendence of Banks had approved the establishment of 14 financial groups, 11 of which include licensed offshore banks.
The Guatemalan Congress passed strong anti-money laundering legislation in December 2001, and Guatemalan authorities developed an aggressive plan to prevent use of its financial system by money launderers, e.g., enactment of regulation to control offshore activities and establishment of a Financial Intelligence Unit. The recent progress in money laundering and bank regulatory reform led to Guatemala's removal from the Financial Action Task Force's list of non-cooperating countries in the fight against money laundering in July 2004.

There are two principal commercial exchanges that deal almost exclusively in commercial paper and government bonds. There is virtually no market in publicly traded equities. Borrowers now face real interest rates in the range of 3-13%. Foreign investors are reported to be active participants in financial markets and are large holders of government debt. Foreigners rarely rely on the local credit market to finance investments.

A.10. Political Violence

The Guatemalan government and the guerrillas of the Guatemalan National Revolutionary Unity (URNG) signed an Accord for a Firm and Lasting Peace on December 29, 1996, ending the 36-year internal armed conflict. Political violence, which was already much reduced from the worst years of that conflict (1979-1984), decreased to even lower levels after the demobilization of guerrilla

forces and civilian defense patrols, and a dramatic reduction in the size and role of Guatemala's regular army. Resumption of large-scale armed political conflict appears a remote possibility, though there are occasional incidents of violence associated with organized land invasions, protests against mining, and the like.

While political violence is much reduced, Guatemala is experiencing a post-conflict wave of common crime, including kidnapping, car-jacking and robberies of banks and armored cars. Personal security from crime was a major campaign issue in the 2003 general elections and remains a widespread concern, according to public opinion surveys. Violence is sufficiently widespread in Guatemala that it is often impossible to tell whether crimes, including murders, are motivated by politics, interpersonal conflicts, organized crime activities, or are simply the result of random violence. Foreigners are not singled out as the targets of crime but, like Guatemalans, must remain watchful. Large firms report that security adds as much as 25 percent to the variable cost of doing business in Guatemala.

Guatemala has a border dispute with Belize, and territorial sea disputes with Belize and Honduras. Guatemala remains committed to resolving these disputes through diplomatic means. Talks with Belize under the auspices of the Organization of American States (OAS) have stalled. Honduras is participating in the Guatemala-Belize discussions leading to resolution of its maritime dispute with Guatemala.

A.11. Corruption

Though bribery is illegal under the penal code, corruption is a serious problem that companies may encounter at nearly any level. Investors have historically found corruption most pervasive in customs transactions, particularly at ports and borders away from the capital. Guatemala ratified the Inter-American Convention against corruption in July 2001, but has not implemented all of its provisions, such as criminalizing illicit enrichment. However, enrichment related to narcotics trafficking activity is now illegal. Several senior officials who served during the Portillo Administration are under investigation for their role in corruption scandals, and the former Finance Minister, Comptroller General and Superintendent of Tax Administration are in jail pending trial. The former Vice President is free on bail, as are several senior military officers charged with looting the military budget during the previous administration. Guatemala signed the UN Convention against Corruption in December 2003, but it has not been ratified.

¶B. Bilateral Investment Agreements

Guatemala has signed bilateral investment agreements with Argentina, Cuba, Chile, France, South Korea, Spain, Taiwan, and The Netherlands. Guatemala has also signed bilaterally or in conjunction with other Central American countries, free trade agreements with Mexico, the Dominican Republic and the United States (pending ratification) and is currently negotiating free trade agreements with Chile, Canada and Panama.

¶C. OPIC and Other Investment Insurance Programs

Guatemala ratified the Multilateral Investment Guarantee Agreement (MIGA) in 1996. The Overseas Private Investment Corporation (OPIC) is active in Guatemala, providing both insurance and investment financing. Obtaining Foreign Government Approval (FGA) for OPIC applicants has generally been very fast. For more information on OPIC programs, U.S. investors should contact OPIC headquarters in Washington, D.C. at tel. (202) 336-8685.

¶D. Labor

The minimum wage and maximum weekly working hours are established by law and revised periodically. The current minimum wage per day, after a recent legislative increase, is USD 4.98 in agriculture and USD 4.12 in commerce (at exchange rate of USD=Q7.75). Current law requires an incentive bonus be added to this minimum wage for all hours worked, effectively bringing up the minimum wage to USD 5.81 per day in agriculture and USD 5.97 per day in commerce. The wages of workers with high-level technical skills however, can reach USD

25.00 per day. For day shift workers the standard, six-day work-week is 44 hours; for night shift workers it is 36 hours; for swing shift workers it is 42 hours. Time-and-a-half pay is required for overtime work. The Constitution guarantees the right of workers to unionize and to strike (Article 102 paragraph (q), and Article 104); the Constitution also commits the state to supporting and protecting collective bargaining and to respecting the stipulations of international labor conventions (Article 106). The rate of unionization is very low. According to Labor Ministry statistics, 56,000 people -- approximately 3 percent of the country's formal labor sector -- were union members in 2003, the last year reported.

Managers of Guatemalan companies must be either Guatemalan citizens or resident aliens with work permits. The labor code specifies employer responsibilities regarding working conditions, especially health and safety standards, benefits, severance pay, and bonuses. Employers are legally required to pay bonuses equivalent to one month's salary in July and December. The law establishes a two-month probationary period for new employees. If dismissed at any time after completing this two-month period of employment, employees receive separation pay equal to one month's pay for each year worked. Employers are required to make a 12.67 percent contribution for social security. Mandatory benefits, bonuses, and employer contributions can add up to over 60 percent of an employee's base pay. Many workers, especially in agriculture, do not receive the full compensation package mandated in the labor law and in practice many labor rights are not well-enforced.

The estimated 1.8 million individuals in the formal sector workforce are augmented by at least three million more who work in the informal sector. Many of these are underage for formal sector employment. In rural areas in particular, child labor remains a serious problem in certain industries. The availability of a large, unskilled and inexpensive labor force has led many employers, such as construction and agricultural firms, to use labor-intensive production methods. Over a quarter of the overall workforce is illiterate. In developed urban areas however, education levels are much higher, and a workforce with the skills necessary to staff a growing service sector has emerged. Even so, highly capable technical and managerial workers remain in short supply.

USTR closed its review of worker rights in Guatemala at the conclusion of the 2003 annual review of the Generalized System of Preferences as a result of positive steps taken by the government in conjunction with the recently concluded U.S. Central American FTA, which includes binding labor provisions.

¶E. Foreign Trade Zones/Free Ports

Guatemalan law permits the establishment of "free trade zones." Currently, there are twenty-one authorized free trade zones in Guatemala, twelve with operations. Textile assembly operations are the common beneficiaries of Guatemala's free trade/maquiladora laws.

¶F. Foreign Direct Investment Statistics

There is no reliable data on foreign direct investment.

Major U.S. companies, including investors:
(representative, but not a complete listing)

ACS
American Cyanamid Co.
Avon products
Cargill
Citibank
Coastal Power
Colgate Palmolive
Constellation Power
Exxon
Gillette
Kellogg Co.
Kimberly Clark Corp.
Levi Strauss & Co.
Marriott Hotels
3M

Phillip Morris Inc.
Proctor and Gamble
Railroad Development Corporation
Ralston Purina
Sabritas-Frito Lay
Teco Power Services
Texaco
Warner Lambert
Xerox

Other major foreign investors:

Barcelo Hotel
BD Centroamericana
Bimbo de C.A.
Cindal-Nestle
Elektra
Ericsson de Guatemala
Shell Oil
Siemens
Telefonica de Espana
Telmex
Union Fenosa

End text.

Hamilton